

MINUTES OF THE CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

June 17, 1997

The Capital Projects and Bond Oversight Committee met on Tuesday, June 17, 1997, at 1:00 p.m. in Room 129 of the Capitol Annex. Representative Robert Damron, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Robert Damron, Chairman; Senator Bob Leeper, Vice-Chairman; Senators Tom Buford and Denny Nunnelley; Representatives Drew Graham and Paul Marcotte.

Guests: Mary Allen, Ken Clevidence, Jack Miller, University of Kentucky; Jim Abbott, Armond Russ, and Jim True, Facilities Management; Bonnie Howell and Mary Lassiter, Finance and Administration Cabinet; Stephanie Robey, Auditor's Office; Dr. Robert Tarvin, School Facilities Construction Commission; Chris Bowling, Hilliard-Lyons; Charles Musson, Rubin & Hayes; Earle Clements, Allen Holt, and Bill Hintze, GOPM; Bob Bender, Department of Parks; Marlana Mitchell, Council on Postsecondary Education; Porter Dailey, Morehead State University; Kim Blitch and Bart Hardin, OFMEA; Kim Burch, Charles Shirley, and Karen Crabtree, LRC.

LRC Staff: Mary Lynn Collins, Scott Varland, Pat Ingram, and Shawn Bowen.

Senator Buford made a motion to approve the minutes as submitted of the May 21, 1997, meeting. The motion was seconded by Representative Graham and approved by voice vote.

Chairman Damron said two correspondence items were included in this month's folders: the Kentucky Lottery Corporation's monthly financial status report for April and a letter from the University of Kentucky responding to questions raised at the May meeting regarding the Center for Academic and Tutorial Services (CATS) expansion project.

bid packages. Mr. Clevidence said that an Alumni Committee has been actively raising funds for this project for some time and all additional money will come from private funds. The increase in scope will require no additional operating funds, and the revised project scope is \$5,850,000 (\$5,600,000 from private funds and \$250,000 from agency funds).

Mr. Clevidence reported the project has been bid and should be complete in August 1998. The new fraternity house will be a 29,000 sq. ft. building, and will house 52 individuals, including an apartment for a house manager. The new fraternity house will be built on the site of the old fraternity house demolished last Spring.

The \$250,000 in agency money budgeted for this project will be used for communications infrastructure projects, a retaining wall, fencing, and parking facilities.

In response to a question from Chairman Damron, Mr. Clevidence said plans have been dropped for an annex facility.

Chairman Damron asked why there was such a large increase in scope, and what was being done inside the facility. Mr. Clevidence responded that square footage is being added and finishes and systems are being upgraded. He said the Alumni Committee wanted this to be a quality project and members have been involved in programming and design through all phases of the project.

Chairman Damron asked Mr. Clevidence for his assurance that this increase in scope was 100% privately-funded. Mr. Clevidence said this was the case.

Senator Buford moved for approval of the scope increase on the Sigma Alpha Epsilon Fraternity House replacement. The motion was seconded by Senator Leeper and approved by voice vote.

The next item of business was the lease report by the Finance and Administration Cabinet. Mr. Jim Abbott, Director, Division of Real Properties, reported the leasehold modification of PR-3622, Cabinet for Families and Children in Perry County. The lessor is Micahroi Ltd., and \$1,360 is to be amortized over the remainder of the lease (through June 30, 2001), which will add approximately 4.5¢ per sq. ft. to the cost of the lease. Improvements include installation of 30 additional isolated circuits in the building to alleviate electric current problems created when the Cabinet installed

The first bond issue she reported was a Kentucky Housing Corporation (KHC) issue for \$64,820,000. The bonds issued were in four series (A, B, C, and D) and all closed on May 22. The underwriter was Merrill Lynch & Co; bond counsel was Kutak Rock; and underwriter's counsel was Peck, Shaffer & Williams. The mortgage rate on housing loans originated with these funds is 7.5%.

Two bond issues were sold last month by the Kentucky Higher Education Student Loan Corporation. The first issue was \$4,910,000, and was issued in four series, which was replacement refunding. The securities were sold on May 7 and closed on May 15. PaineWebber was the underwriter; Hawkins, Delafield & Wood the bond counsel; and Kreig, DeVault, Alexander & Capehart the underwriter's counsel. Ms. Lassiter said the transaction went very well.

The other Student Loan Corporation issue was for \$135,000,000 and was issued in two series for the origination and purchase of student loans. These issues sold May 7 and closed May 15. These are variable rate securities with a 35 day reset. PaineWebber was the underwriter; Hawkins, Delafield & Wood the bond counsel; and Kreig, DeVault, Alexander and Wood the underwriter's counsel. Ms. Lassiter said this transaction also went well.

The next issue reported was the University of Kentucky's Housing and Dining System Revenue Bonds, 1997 Series Q for \$6,645,000. This is a new money transaction for renovations to existing housing and dining facilities. The bonds sold May 6 and closed May 29. The net interest cost was 5.9%; Hilliard-Lyons was the financial advisor; and Peck, Shaffer, and Williams was the bond counsel.

Ms. Lassiter next discussed tax and revenue anticipation notes (TRAN) to be issued by the Kentucky Asset/Liability Commission and authorized by House Bill 5, 1997 Special Session. She said the Commission plans to issue its first TRAN on July 8. The purpose of the issue is to provide working capital for the General Fund during seasonal periods when revenue is less than expenditures. The Commission plans to sell \$200,500,000 in one-year fixed-rate notes. Issuance costs are expected to be approximately \$500,000; the net interest rate expected is 4%; the sale will be negotiated with Bear Stearns as the underwriter; Peck, Shaffer & Williams as bond counsel; and Brown, Todd & Heyburn as the underwriter's counsel.

\$401,000 (93%) per year. Ms. Lassiter said there would be no new taxes associated with the bonds to be sold on July 9.

Representative Graham made the motion to accept the two new bond issues for Lawrence County and for Montgomery County using SFCC funding. The motion was seconded by Senator Buford and passed by voice vote. Chairman Damron abstained from the vote.

The next item of new business was the local school district new bond issues. Senator Leeper recognized Mr. Chris Bowling, Hilliard-Lyons, and Mr. Charles Musson, Bond Counsel from Rubin & Hayes, who had asked for an opportunity to address the Committee concerning a tax and revenue anticipation note (TRAN) to be sold by the Kentucky School Boards Association. The Committee reviewed the issue at its May meeting, but Mr. Bowling stated that since this is the first year of the program sponsored by the Kentucky School Boards Association, he wanted to make a presentation to the Committee and was unable to attend last month's meeting because of scheduling conflicts related to the Special Session.

Mr. Bowling said generally school districts borrow money internally, transferring money between their general fund and their special funds, to cover expenditures while waiting to be reimbursed from tax revenues, and federal and state grant moneys. The TRAN program will allow school districts two options. They can utilize TRAN money to finance short-term cash management issues and keep their general fund moneys invested longer, or they may continue to borrow internally and use the TRAN money to earn interest.

Mr. Bowling stressed the responsibility of the fiscal agents in this program to adequately estimate deficits schools experience during the year. IRS rules limit the size of a TRAN to the deficits experienced by the eligible issuer. Because of those restrictions, estimates of deficits are done conservatively and with the school district's assistance.

Mr. Musson addressed the Committee on tax compliance regulations. He said they have reviewed Hilliard-Lyons financial analyses with various school districts to assure compliance with Section 148 of the Internal Revenue Code and corresponding tax regulations. He said they have stressed to Hilliard-Lyons and to the school districts the need to make sure the numbers put into the pro-formas are based

Senator Nunnelley asked how many associations or groups are now issuing TRANS or similar programs, and if an entity can participate in more than one at a time. Ms. Collins, Committee Staff Administrator, indicated that the only TRANS the Committee sees are those issued by schools and state government. However, local governments are also issuing them.

Mr. Musson stated that each school district can issue TRANS individually. The problem is, in most cases, TRANS are not economically feasible unless the districts pool their resources together to cover issuance costs. He said that school districts can participate in more than one association's TRANS issue.

Senator Buford asked about regulations for review of TRANS and if the financial reports are reviewed by the Department of Education or by a certified public accountant. Mr. Musson said there are no regulations on how TRANS are reviewed. He said normally the chief financial officer of the school district is responsible for reviewing the numbers. He also said that the Department of Education is looking into how to oversee such programs.

Senator Buford asked if a requirement was needed for review of reports by certified public accountants. He said this would assure the Committee someone reviewing the issues understands them. Mr. Musson said it was something that needed to be watched over and protected because it could have an effect on the local school district. Mr. Musson said the MUNIS accounting system that schools are moving to provides much more detailed accounting. The system will assist schools in more accurately tracking expenditures and revenue flows.

In response to a question from Senator Buford, Mr. Bowling responded that most schools will be using the MUNIS System next year, and about 2/3 of schools are already using it.

In response to another question from Senator Buford, Mr. Musson responded that he thought the majority of school boards did not have a certified public accountant looking at the TRANS. He said this was one of the reasons they have stressed to Hilliard-Lyons that they must explain the program to participants and ask questions about revenue and expenditure data submitted by participants. He said they have also stressed that TRANS issues cannot be based on statewide assumptions, that each issue

tax revenues are bought up, they close schools, or make layoffs in order to bring expenditures down.

Representative Marcotte asked what the benefit would be to the Beechwood Independent School District under this program. Mr. Bowling said he could not answer the question since they have not analyzed Beechwood's finances yet. Conceptually, the spread between tax-exempt one year notes and one year taxable notes is about 1.9%. This 1.9% spread must cover the cost of issuance, and after the cost of issuance is paid out, there is usually a 1.2% to a 1.3% spread (earnings) for the district if they do not draw down the funds and continue to borrow internally from the general fund to cover deficits.

Mr. Musson added that the school has the option to draw down funds at any time during the year. Funds are then put into an account and are there for the district's use.

Senator Nunnelley asked why a school district would not draw down their funds. Mr. Bowling said that a school district can continue to borrow funds internally from the general fund to cover a deficit, and let the TRAN funds continue to earn interest. If the funds are drawn down to cover a deficit, they must be back in their account by April 1, and they cannot borrow funds after this date.

Senator Nunnelley asked who would get the interest from April 1 to June 30. Mr. Musson responded that the school district will get the accumulated interest from July 1 to June 30. Mr. Bowling added that they would only be able to keep a certain amount because a portion of the earnings will pay for the cost of issuance of the program.

Mr. Musson said the school districts have total control of the funds. The only requirement, imposed by Standard & Poor's, is the money is to be back into a sinking fund by April 1. This will ensure that if a district is unable to make their payment, the financial advisors will have time to talk with the district and decide how to finance the payment of notes.

Senator Nunnelley asked what kind of investments are made on behalf of the school district. Mr. Musson responded that the types of investments will be those that are acceptable for the Commonwealth of Kentucky and that are laid out in state

Senator Nunnelley asked when the financial agents involved are paid their fees. Mr. Bowling answered that all fees are paid out at the closing of the bond issue on July 1 and the interest earnings on investments are sufficient on June 30 to pay interest.

In response to a question from Senator Buford, Mr. Musson said schools can use the funds from their investment for any normal school system expense.

Senator Leeper noted that a number of 100% locally funded school bond issues were submitted to the Committee this month: the Kentucky Interlocal School Transportation Association (TRAN for \$75,000,000); Ludlow Independent (\$500,000); Providence Independent (\$50,000); Beechwood Independent (\$500,000); Cloverport Independent (\$270,000); and Russell Independent (\$422,000). Senator Leeper said staff had reviewed the new locally-funded bond issues and found them to be in compliance with statutory disclosure requirements. He said no action is required by the Committee for the school bond issues that are 100% locally-funded.

Mr. Bill Hintze, Governor's Office for Policy and Management, reported on the next two agenda items: one project approved through the Finance and Administration Cabinet which needed Committee action and an update on the Statewide Deferred Maintenance Pool.

The first project reported was the Morehead State University (MoSU) Folk Art Museum Renovation. The Finance and Administration Cabinet requested approval for a \$200,000 cost overrun on the Folk Art Museum project originally authorized by the 1994 General Assembly at \$678,000. (The Committee approved a \$296,500 cost overrun on the project in March of 1995). The additional funds will be used to complete work on the museum's second floor, including floor coverings, HVAC, electrical, plumbing, and interior walls and ceiling work. Of the \$200,000 increase in scope, \$160,000 will be from the U.S. Highway Administration Intermodal Surface Transportation Efficiency Act (ISTEA), and the remaining \$40,000 in matching funds will be from restricted agency funds. The new project scope will be \$1,174,500.

Senator Leeper made the motion to approve the \$200,000 cost overrun on the Morehead State University Folk Art Museum, using \$160,000 in ISTEA funds, and \$40,000 in restricted agency funds. The motion was seconded by Representative Graham and passed by voice vote.

Mr. Hintze said four projects, to date, have been approved utilizing funds from this account: State Police - \$48,100 for the replacement of a boiler; Library and Archives - \$303,000 for silo repairs; Finance and Administration - \$189,000 to replace carpets on the third and sixth floors of the Human Resources Building; and the Kentucky Horse Park - \$100,000 for a water and drainage problem in the elevator shaft at the Kentucky Horse Park Museum.

This fund received an initial appropriation of \$3,550,000 from the 1996 General Assembly under House Bill 379. As of May 31, 1997, expenditures totaled \$640,100, and the cash balance remaining is \$2,909,900.

Chairman Damron asked if the money would automatically lapse back into the General Fund at the end of the second year of the biennium, then need to be re-appropriated, or will it automatically carry forward like the emergency account and the contingency account.

Mr. Hintze said he thought the money would have to be reauthorized by the General Assembly and it would not automatically carry forward at the end of the second year.

In response to a question from Chairman Damron, Mr. Hintze agreed that it would make more sense to have this account set up so if money is put in, it stays there for that purpose rather than rolling back into the General Fund at the end of the biennium. Mr. Hintze stated that there are more deferred maintenance needs than there are funds available.

Chairman Damron asked staff to investigate the possibility of having the Statewide Deferred Maintenance Pool Account mirror the emergency and contingency accounts. If statutory changes are necessary, he directed staff to draft legislation for consideration by the 1998 General Assembly.

Chairman Damron announced the following informational items in the Committee's folders: summary of legislation enacted during the May Special Session on higher education; a summary of the study by the Program Review and Investigations Committee on capital construction; and proposed administrative regulations for the new Drinking Water State Revolving Loan Fund.

Director, Public Corruption Unit; Mr. David Williams, Special Investigator; and Ms. Karen Timmel, Assistant Attorney General, Special Prosecutions Division.

Chairman Damron asked that Committee members hold their questions until after the panel presented their findings. After the presentation and the questions, Chairman Damron said Mr. Cubine will then be asked to make recommendations. Chairman Damron asked the AG's Office to work with the Committee's staff to draft legislative recommendations that can be provided to the Finance and Administration Cabinet as well as to the Governor's Office for review and consideration and their possible comment at the Committee's July or August meeting.

Mr. Cubine said the panel may not be able to address all questions raised by the Committee. He explained that under Kentucky Open Records Law, once an investigation is closed, the records become open to the public. However, there are a number of documents gathered by either federal or state grand jury subpoenas which are not subject to the Open Records Law and are to remain sealed as part of grand jury proceedings.

Mr. Jim Huggins stated the investigation into the proposed lease of office space for the Justice Cabinet in Frankfort was started based on a September 15, 1996, Courier Journal newspaper article written by Mr. Tom Loftus. In two interviews, Mr. Dan Cherry, Secretary of Justice, was quoted as saying his agency was planning to move into a new building under construction on Versailles Road in Frankfort and owned by Capital Complex East LLC. At that time, the state had not advertised for bids for a new building for the Justice Cabinet.

Based on the article, the AG's Office determined that there may have been some irregularities in the leasing process and possibly violations of state law. The investigation was opened on September 16, 1996, and the goal was to determine if state or federal laws were violated. Records were subpoenaed dealing with this lease, and numerous individuals working for the Finance and Justice Cabinets were interviewed.

Mr. Huggins stated a voluminous amount of records were subpoenaed and thoroughly reviewed. In that review, staff found possible violations of federal law including bank fraud, and the FBI joined the investigation. A federal grand jury was utilized to obtain records and take testimony from certain witnesses. After grand jury

not discovered any evidence that any state official was profiting from his or her actions in this process. Any failure to follow the state statute regarding the letting of bids or the open and notorious giving of preferential treatment to one bidder, without more, is beyond the purview of federal law."

Later in the investigation, Secretary Cherry was quoted in another newspaper article as saying the Justice Cabinet was not moving and they had ample space. At this point, the case was reviewed by the staff attorney, Ms. Karen Timmel and others in the AG's Office, and they decided not to prosecute, primarily because the move did not take place.

Mr. Huggins said, at that point, Attorney General Chandler and Mr. Cubine decided to proceed through the legislative process by proposing legislative remedies to strengthen the state leasing statutes relating to collusion.

Mr. Huggins then called on Mr. David Williams, chief investigator of the case. Mr. Williams began by noting that Secretary Cherry indicated in an interview with a reporter that he and his executive staff had visited the site and looked at the building's floor plans and said: "I don't know how official it is. I'll put it this way, that's the game plan, we're looking at probably a February move date."

Mr. Huggins said in February of 1996, the state advertised for 41,000 sq. ft. for the Department of Corrections. Three Frankfort property owners responded by letter stating they had space to offer. The Finance Cabinet, Division of Real Properties, rejected all three offers because none had enough floor space in one location. Mr. Williams noted then Corrections Commissioner Jack Lewis, wrote in a March 4 memo: "As I understand it, there could be several other options available in Franklin County in the very near future and it may be worth waiting for several more months in the interest of competition and selection prior to making a final decision."

Later, Secretary Cherry sent a memo to Secretary McCarty that suggested expanding the scope of the project and combining the new Corrections Offices with other Justice agencies. The memo further suggested that all the needs could be met in one 60,000 sq. ft. building. Secretary McCarty agreed, and on March 25 and 26 the state advertised for a 60,000 sq. ft. building.

Mr. Rodney Ratliff, Capital Complex East LLC, answered the ad with a letter

Mr. Williams said he interviewed the Secretary of Finance and the Secretary of Justice and numerous other personnel in those two Cabinets, including Commissioners, Division Directors, and Secretaries. He said the AG's investigation concluded that the Finance Cabinet may have acted prematurely in seeking property for the Justice Cabinet. Mr. Williams stated that the Finance Cabinet consulted or acted in consort with private property owners or owners by providing certain information prior to any bid process. The Justice Cabinet received documents or information that led them to an understanding that consolidation would be in a particular building. The Finance Cabinet met with owners or principals of a particular building to discuss specific items to be included in the building; drawings were provided by Finance to Justice specific to a particular building; statements were made to a financial institution that a lease for a building under construction would be to the Department of Corrections. Mr. Williams explained to the Committee that included in their packet was a timeline starting with January 10, 1996, and running through September 1996. Also enclosed in the packet was a diagram of the building layout that was provided to the Justice Cabinet from the Division of Real Properties. The Justice Cabinet took the floor plans, made changes and returned them to Real Properties.

Chairman Damron asked Ms. Timmel if she would like to make any statements before the Committee asked questions.

Ms. Timmel stated that their review focused on KRS 56.814, which forbids state employees to disclose information about proposed state leases prior to advertisement. She said her office determined prosecution would not be successful in this case because the lease was never awarded, the Justice Cabinet canceled its request for space, and the investigation did not develop any evidence of any state official receiving anything of value for official actions during the leasing process.

In response to a question from Chairman Damron, Ms. Timmel restated that they did not find any evidence that any state employee received a payoff.

Chairman Damron asked if there was any indication in the records that the owners of the building in question told the bank when seeking a loan that they already had a state lease for the entire building. Mr. Williams responded that a bank official at Bank One stated the builder applying for the loan told her he would be getting a lease with the Department of Corrections and she could verify this by calling the Secretary of Finance.

a coordinator for the proposed new office. Justice Cabinet Commissioners and Secretary Cherry drove by the building site to view progress on the building, and at that point, Secretary Cherry noticed the building was not in an L-shape form like the floor plans they had reviewed indicated, but instead, the building shape was square. Mr. Williams said the Justice Cabinet employee brought the matter to the attention of Mr. Jim Abbott, Division of Properties, and was told the L-shape would be there.

Stressing the fact there was no official request for proposals in place at the time, Senator Buford questioned another portion of the Attorney General's report relating to changes in location of a bathroom in the new building. Mr. Williams explained Real Properties had developed floor plans for Justice based on the Capital Complex East building. He said Justice Cabinet officials requested a change in a bathroom for the Secretary's use. Staff with the Division of Real Properties then asked one of the owners if it would be a problem to change the bathroom location. Staff with the Division of Real Properties explained to Mr. Williams in an interview that the owner was not told to put the bathroom in the building, simply asked if it would be a problem. Mr. Williams stated the contractor waited until they got a determination as to whether or not to put the bathroom in that location. Eventually, they decided to go ahead and put the plumbing in and pour concrete so they could continue with construction.

Mr. Williams said, at one point, the Justice Cabinet coordinator for the project asked an official in Real Properties "How close to illegal are we?" The coordinator was told it was no problem.

Senator Buford said the state needs to develop legislation to put new safeguards in the leasing process or build its own office space.

Senator Buford asked about a log required to be kept by the Finance Cabinet, detailing conversations between state officials and potential lessors. Mr. Williams stated that on this particular project, no log was required because the requirement does not apply until final bids are submitted. However, he said he asked if the log was kept on other projects once final bids are submitted. He said he was told by a staff person with the Division of Real Properties there was a log, but he did not think it was kept current. Mr. Williams said upon receiving a faxed copy of the log, he noted the initial entry was dated 1991 and the last dated entry 1993. There were a total of 10 entries on the log, three of which had no year or date listed. No entries related to any recent leases of state property.

Chairman Damron asked the panel, based on the information provided in the investigation, if the building in the Capital Complex East was constructed to meet specific needs of the Justice Cabinet . Ms. Timmel said they could not speculate on what the ultimate outcome would or could have been outside of what the evidence disclosed in the report.

Chairman Damron asked Ms. Timmel if Justice Cabinet employees had discussions with owners of the building or with the construction manager. She said Justice Cabinet employees viewed the site, but did not have discussions with the owners or the construction manager. Justice Cabinet employees dealt only with the Finance Cabinet. In response to a question from Chairman Damron, Ms. Timmel said employees from the Finance Cabinet did have discussions with the owners of the building.

Chairman Damron asked if this then was not evidence of a violation of the statute, and if so, why did the state chose not to prosecute. Ms. Timmel said the statute, KRS 56.814, is vague. Subsection 2 says discussions of an approved leasing plan pertaining to space requirements may be held with persons interested in submitting a proposal after space needs are advertised. She stated there was an advertisement for 60,000 sq. ft. However, responses to that advertisement were rejected and plans proceeded for a larger building. She said the difficulty in determining whether or not to proceed on a prosecution is the clarity of the statutory violation, the strength of the evidence, the strength of the defense, corroborating testimony, credibility of witnesses and other factors. Ms. Timmel said because they thought the statute was not clearly defined as to what type of information can and cannot be disclosed, it would be a difficult statute to prosecute.

Ms. Timmel said the penalty section of the statute imposes severe penalties--from 1-10 years imprisonment--if something of value is obtained and in the case of premature disclosure of information, the penalty is a year. To get a conviction, it is necessary to show a willful and intentional violation of this provision. The best proof would be something in writing from the person making the commitment, an informant, or a sting operation. Ms. Timmel stated the difficulty comes in interpreting subsection 2 as to when it is and is not proper to speak with persons interested in submitting a proposal.

Senator Leeper asked the panel to restate why the AG decided not to

prosecution because the statute that prohibits disclosure of leasing plans prior to advertisement is outside the penal code, so it is questionable whether criminal intent applies to that particular statute. Secondly, she said there was not enough evidence to get a conviction on that particular charge.

Senator Leeper asked the panel if similar situations happened in the past or are currently happening, and did they have reason to believe this was not an isolated incident. Ms. Timmel answered that she didn't think they could answer that because their investigation focused on specific allegations. She said their investigation exposed the possibility of this type of behavior and abuse of the process. She said this is the reason why they want to come forward with a proposal to correct the problem.

Senator Buford asked a member of the panel to explain a portion of the Attorney General's report that discusses the addition of a loading dock to the Capital Complex East building. Mr. Williams said that when the Justice Cabinet met with its employees to ask what they would like to see in their new offices, one of the employees requested a loading dock facility. On the original drawings turned in to the Division of Real Properties, there were no designs for a loading dock. Staff from the Division of Real Properties indicated to the owners of the property that they would prefer a loading dock, but according to interviews, they did not tell the owners to install a loading dock. A loading dock was later added to the building.

Mr. Williams said they have a fax from the owners of the building to Real Properties giving an update on the construction of the building. He said they also had communications between interior design staff from the Division of Real Properties and principals associated with the building that discussed locations of parts of the building. He said this was not a single, isolated incident by any means.

Senator Buford commented that it was disturbing that the Justice Cabinet and the Corrections Department did not follow proper procedures.

Chairman Damron asked the panel if, prior to the March 25 advertisement, there was any evidence that Real Properties let Capital Complex East know the space needs for the Justice Cabinet were going to be in excess of 60,000 sq. ft. Mr. Williams said the Justice Cabinet submitted a request for additional space of 64,000 sq. ft.; a later interview suggested 65,000 to 72,000 sq. ft. may have been needed. Mr. Williams said he had no documentation showing the owners were told to increase the amount of

the Committee, saying in the original drawing the square footage was recalculated because of errors in the calculation of the square footage needed. He said the initial request was for 60,000 sq. ft. but when bathrooms and common areas were taken into account, this reduced the total amount of useful square footage. From that point, a new diagram of Justice office space was initiated in an L-shape. Then in September, the general contractor obtained a blueprint with the additional 20,000 square feet.

Chairman Damron asked if any other owners that submitted bids expanded their buildings. Mr. Williams answered no. He said he asked staff of the Division of Real Properties if any other owners were kept advised of the same information and was told they were not.

Chairman Damron said it was a situation where one bidder is treated differently from other potential bidders. Others were not given the same opportunity to expand their building to meet the state's needs.

Chairman Damron asked the panel if they knew of any other buildings in Frankfort that could have offered rental space in excess of 60,000 sq. ft. Mr. Cubine answered that they had no knowledge of that information.

Senator Leeper asked if the owners of the building lease any other buildings to state agencies. Mr. Cubine answered that one or more of the partners in this project do hold other state leases.

Senator Buford said he believed the same people associated with Capital Complex East have about 30% of the leased property in Frankfort.

Senator Leeper asked the panel if they investigated the way the other state leases came about. Mr. Williams said they focused on this one lease.

Senator Leeper asked the panel if they thought they should have looked into the way other state leases are awarded. Mr. Cubine stated the investigation was done on one specific case. He said the state has over 600 leases, and it would be a matter of having enough resources to do that type of review.

Senator Leeper commented that if statements are being made that this is rampant and we need to change the way things are done, then it should not be too hard

Chairman Damron asked the panel if the Finance and Administration Cabinet cooperated with the investigation. Mr. Huggins said for the most part they did.

In response to a question from Chairman Damron, Mr. Huggins said the Finance Cabinet conducted an internal investigation into the matter and concluded that there was no wrongdoing.

Senator Buford said the state needs to figure out how to prevent something like this from happening again and questions should be answered as to why this happened and why the log has not been maintained.

Senator Buford made a motion that the results of this review and the pending proposed recommendations by the Committee and the AG's Office, after consultation with the Finance and Administration Cabinet, be forwarded to the Program Review and Investigations Committee. The motion was seconded by Representative Marcotte and passed by voice vote.

Mr. Cubine referred to the handout entitled "Comparison of Current State Leases Process under KRS 58.803 with Proposal." He said the state has approximately 695 leases, representing \$28.7 million annually. Nine percent of the leases (68) represent 51% of the current expenditures, almost \$15 million in annual lease payments. He said his office was proposing use of a state lease selection committee for new leases. He said the selection committee would include representatives from the agency requesting the space, from Finance, from the Auditor's office, and two representatives from the Board of Realtors and from the Board of Real Estate Appraisers.

Mr. Cubine stated that this proposal would also change the penalty provision to say if any landlord is found in violation regarding a state lease, the landlord would be banned from holding a state lease for five years.

In response to a question from Chairman Damron, Mr. Cubine said the proposal would cover renewals of leases over \$100,000.

Chairman Damron said the Committee's staff will work with Mr. Cubine's staff, and forward recommendations to the Finance Cabinet.